

***United States Court of Appeals
for the Second Circuit***



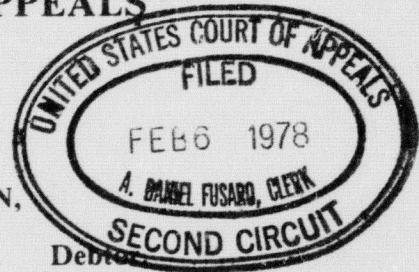
APPELLEE'S BRIEF

77-5019

77-5022

**UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

In the Matter of
STIRLING HOMEX CORPORATION,



**GREGORY JEZARIAN, GERALDINE JEZARIAN,
LONETOWN COMPANY, HARRY E. JONES, ALECK
GOLDBERG, as Custodian for Mark Goldberg and Mrs. D.
WINDSOR DIXON,**

Appellants,

**FRANK G. RAICHLE, Reorganization Trustee; LINCOLN
FIRST BANK OF ROCHESTER; CHEMICAL BANK;
THE CHASE MANHATTAN BANK, N.A.; THE FIRST
NATIONAL BANK OF CHICAGO; MARINE MIDLAND
BANK; and THE TRAVELERS INDEMNITY COMPANY,**

Appellees.

**Appeal From the United States District Court For The
Western District Of New York**

**BRIEF OF APPELLEE, THE
TRAVELERS INDEMNITY COMPANY**

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 77-5019 and 77-5022 (consolidated)

IN THE MATTER OF
STIRLING HOMEX CORPORATION,
Debtor,
GREGORY JEZARIAN, et al.,
Appellants.

Appeal from the United States District Court
for the Western District of New York

BRIEF OF THE APPELLEE THE TRAVELERS INDEMNITY COMPANY

STATEMENT OF THE ISSUES

1. Did the Court below err in subordinating the claims of allegedly defrauded preferred and common stockholders of an insolvent debtor, to those of the debtor's unsecured conventional creditors under a plan of reorganization under Chapter X calling for liquidation.
2. Should the Jezarian, Lonetown & Dixon appellants be permitted to file so-called "fraud claims" where no attempt was made to file such claims until nearly four (4)

years after the Bar Order date for filing claims.

STATEMENT OF THE CASE

The Travelers Indemnity Company (Travelers) joins in the statement of the case contained in the brief of the Appellees, Chemical Bank, et al but adds the following supplemental facts with respect to the Appellee Travelers.

This brief is submitted on behalf of the Appellee, Travelers and is supplementary to the briefs submitted on behalf of the Appellees, Chemical Bank, The Chase Manhattan Bank, N.A. and The First National Bank of Chicago, and on behalf of the Appellee Reorganization Trustee.

Travelers issued various payment, performance and other miscellaneous contract bonds as surety for Stirling Homex Corporation and for its various affiliated and subsidiary corporations, collectively referred to in this brief as "Stirling Homex."

In addition to constructing the modular housing units, Stirling Homex engaged in the installation of the modules often on a "turnkey" basis. (A 158) In connection with the installation of the modules, Travelers issued payment and performance bonds as surety.

At the time of the filing under Chapter X, there were at least seven projects in progress where Travelers had issued payment and/or performance bonds for Stirling Homex. (A 159) As a result of Stirling Homex' inability to continue these projects and to pay various subcontractors,

materialmen and others furnishing their labor and talents on those projects, Travelers, by virtue of the bonds issued, paid claims of numerous subcontractors and materialmen. In addition, Travelers, by virtue of the performance bonds, arranged for the completion of numerous bonded projects.

(A 159)

Due to Stirling Homex' inability to complete the projects and to pay the bills of subcontractors and materialmen incurred by them on the bonded projects prior to filing under Chapter X, Travelers paid out of its own funds, net of amounts received from contract balances, a sum of approximately \$5,000,000. (A 159)

Travelers duly filed its unliquidated unsecured claim as a general creditor on or about February 14, 1973. (A 169) Subsequently and by the time the Trustee filed his Section 167 report on April 18, 1977, the Travelers had liquidated its claim to the extent of approximately \$5,000,000. (A 169)

POINT I

THE TRAVELERS, AS SURETY, IS SUBROGATED TO ALL OF THE RIGHTS AND REMEDIES OF THOSE MATERIALMEN AND SUBCONTRACTORS WHOM IT PAID AND TO THOSE OWNERS WHOSE PROJECTS IT COMPLETED

The Travelers by virtue of payments to subcontractors and materialmen has acquired the rights and remedies of those subcontractors and materialmen. These rights acquired by way of subrogation are an addition to its rights of

indemnification against Stirling Homex.

The Courts have uniformly recognized the subrogation rights of the surety to the rights and remedies of those whose debts it has paid.

"Traditionally sureties compelled to pay debts for their principal have been deemed entitled to reimbursement, even without a contractual promise such as the surety here had. And probably there are few doctrines better established than that a surety who pay the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed."

Pearlman v. Reliance Insurance Company, 371 U.S. 134, 136-137, (1962).

Travelers is also subrogated to those rights of the Owners of the various projects which were completed by Travelers at a loss pursuant to the performance bonds issued by Travelers as surety for Stirling Homes. See Prairie State National Bank v. United States, 164 U.S. 227 (1896); Pearlman v. Reliance Insurance Company, 371 U.S. 134 (1962).

Travelers is thus in the same position as those subcontractors, materialmen and owners who were dealing with Stirling Homex on a day to day creditor relationship.

In its position as a general unsecured orthodox creditor, Travelers should prevail over the so-called fraud claims. Travelers in its own right and as subrogee of trade creditors had every right to rely upon the capital stock of Stirling Homex in extending credit. The stockholder looks

to his equity profit in the security transaction accepting the rules of speculation. The trade creditor, on the other hand, rejects the opportunity for equity profits in favor of fixed dollar returns, relying on the corporation's capital contributions by shareholders.

If anyone has defrauded and/or wronged the stockholder appellees it is the debtor Stirling Homex.

That wrong should not be compensated by ignoring the original investment risks and expectations of all claimants to debtor's estate. There has been no fraud among those claimants, and, therefore, securities laws of rescission and recovery should not effect the order of priority of claim in bankruptcy distribution. If such changes in priority are sanctioned, the court will essentially charge an innocent claimant, the general creditor, with the fraud of the debtor. This conclusion results because the general creditor ultimately pays the securityholders' claim for fraud when the securityholder shares in the general creditors' distribution.

POINT II

WHETHER THE REORGANIZATION COURT ACTED IN EFFECT
UNDER SECTION 63 OF THE BANKRUPTCY ACT OR UNDER ITS
GENERAL EQUITY POWER UNDER SECTION 197 OF CHAPTER X,
THE COURT'S SUBORDINATION OF THE SO-CALLED FRAUD
CLAIMS OF THE STOCKHOLDERS WAS PROPER

The trustee in his brief has taken the position that

under equitable principals and under the authority granted to the Reorganization Court under Section 197 of the Bankruptcy Act, the Reorganization Court was fully within its right to subordinate the claims of so-called defrauded stockholders of those of the orthodox general creditors.

We concur in and adopt Point I of the trustee's brief as our own. (Reorganization Trustee's Brief, 4-24)

We wish to note the dilemma pointed out in the trustees' brief at page 22 relative to the Settlement Agreement between the bank creditors and the trustees. In this regard the trustee most aptly demonstrates that it would be the non-bank general creditors, such as Travelers and small suppliers, who would suffer the most by permitting the "fraud" claims to share on the same basis.

The brief of the appellee Chemical Bank and The First National Bank of Chicago, basically sets forth the position that the Court below was faced with a de facto straight bankruptcy situation and the Plan of Reorganization was nothing more than a liquidation akin to straight bankruptcy under Chapters I to VII.

The factual background of the Chapter X proceedings as set forth in the record, clearly demonstrates that Stirling Homex never continued the manufacture or installation of housing modules after July 11, 1972, the day before the Chapter X petition was filed. The trustee and the employees

of Stirling Homex engaged in an orderly and effective liquidation of the assets of the corporation. Thus the point of the Chemical Bank's brief is well taken that, effectively, the Court is dealing with a de facto straight bankruptcy. Under such circumstances the appellee Chemical Bank argues (Appellee Chemical Bank's Brief, p. 196) that Section 63 of the Bankruptcy Act could be applied by the Reorganization Court in classifying all claims in the Chapter X proceeding. Under Section 63(a) fraud claims (tort) are not provable and hence are not allowable.

In addition appellee Chemical Bank argues that the claims of the appellants are unliquidated. Appellee properly notes that the fraud claims, pending for five and a half years, are still in the discovery stage. Thus, it is rightfully urged that those claims may be disallowed by the Reorganization Court under Section 57(d) of the Act (Appellee Chemical Bank's Brief, 20).

We concur with the appellee Chemical Bank, adopting its arguments set forth in its Point I, (pgs. 14-29), that the subordination of the claims of so-called defrauded stockholders to the orthodox creditors by the Reorganization Court can be justified fully by the application of the normal criteria used where the Court is faced with a liquidation situation.

POINT III

THE APPELLEE TRAVELERS WILL BE UNDULY
PREJUDICED BY PERMITTING THE APPELLANTS
JEZARIAN, LONETOWN AND DIXON AND
OTHER SO-CALLED DEFRAUDED STOCKHOLDERS TO
FILE CLAIMS YEARS AFTER THE BAR ORDER

Based upon the status of the proceedings then existing in May of 1976, Travelers acquiesced in the settlement between the banks and the Trustee. At the time of the settlement hearing in May of 1976, more than three (3) years had elapsed since the Bar Order went into effect and the only so-called stock fraud claims filed were those of appellee Jones and Goldberg. While appellee Jones and Goldberg had filed a class fraud proof of claim, the class fraud proof had been disallowed by the Court (for which no appeal had been taken) leaving those individual claims at \$3,968 and \$2594.63 respectively.

In light of the lapse of time between the Bar Order and the hearing before the Bankruptcy Judge in May of 1976, there could not be any reasonable anticipation of the huge claims of so-called defrauded stockholders now urged by the appellants. The settlement between the banks and Trustee and the acquiescence thereto by appellee Travelers and the other general unsecured creditors was made and approved without objection under conditions where the maximum claims were not expected to exceed 50 million dollars.

With the advent of the settlement, the so-called fraud

claimants appeared on the scene to see if they could share in the feast. If those claims are allowed at this time, there will be slim pickings for the orthodox general creditors.

We adopt fully the Appellee Chemical Bank's arguments in Point II of its brief that the appellants Jezarian, Lonetown and Dixon are time barred in filing their claims based on the Bar Order and also based upon laches.

We also concur with the Reorganization Trustee's brief under Point III (pps. 27-28) that the issues relating to the bank's implication in fraud should be left to the Court proceeding in the District Court for the Southern District of New York, Jezarian v. Csapo.

Any further delay in the liquidation and distribution of the assets of the debtor can only further injure those orthodox general creditors of the debtor.

CONCLUSION

THE ORDER UNDER REVIEW SHOULD BE AFFIRMED IN ALL RESPECTS

Respectfully submitted,

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